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Bears Trample Global Stock Markets

The spectre of the Great Depression loomed in the background as global financial markets experienced record-shattering losses and recoveries during the third week of October. As government and monetary officials attempted to calm markets, waves of selling and buying started in New York and swept around the globe. Most analysts had been expecting a correction, arguing that the U.S. stock market was overvalued. When the correction turned into a rout, however, it raised the prospects for recession and focused attention on the huge U.S. fiscal and trade deficits. While these developments highlight the globalization of financial markets, they have also revealed more subtle relationships.

Capping an extended drive, the Tokyo Stock Exchange Nikkei average of 225 stocks hit a record high of 26,646.43 on October 14 (see Table 1). Reacting to a 100-point drop in the Dow Jones industrial average on October 16, the Nikkei index fell 620 points the following Monday, a 2.3 percent decline. In

response to the Dow's 508-point plunge later that day, Tokyo stock prices plummeted more than 3,836 points or 14.9 percent on October 20. The decline easily surpassed previous record declines in percentage as well as absolute terms (Table 2). Immediately following "black Tuesday," the Tokyo market rebounded 2,037.32 points, the largest single daily gain on record. This was only the beginning of the rollercoaster ride, however, as markets around the globe experienced wild swings. The Tokyo market dropped 1,203.23 points on Friday, October 19, and 1,096.22 points the following Monday before pulling itself up 632.4 points on Tuesday.

Just as President Reagan tried to calm U.S. markets, Prime Minister Yasuhiro Nakasone, Finance Minister Kiichi Miyazawa, Bank of Japan governor Satoshi Sumita and Liberal Democratic Party president-elect Noboru Takeshita all made statements berating investors for ignoring Japan's sound economic condition. The TSE board tried to dampen speculation on October 20 by raising the minimum margin requirement from 30 percent to 50 percent of the purchase price. The impotence of policymakers in Japan and elsewhere was reflected by the continued volatility of global stock markets, which spilled over into foreign exchange, bond and other markets.

The Osaka Stock Exchange's futures market, which sells a contract based on a basket of 50 Japanese stocks, went into a tailspin. Starting October 12 at Y1,410 ($10.07 at Y140=$1.00), prices fell to Y1,156 ($8.26) on October 26. The Osaka exchange temporarily closed the futures market on October 20 because the TSE plunge that day would have forced the price of futures contracts to move more than the 42 yen daily limit; the next day the Osaka board changed the daily ceiling to 250 yen. The change will help protect investors from extreme swings in the TSE average by allowing them to make larger hedges.

The yen-dollar exchange rate has also been battered. The yen strengthened against the greenback during the week of October 12-16 and hit a high of Y141.35 October 19. Throughout the rest of the week it slipped, however, ending at Y144.15. The following Monday the yen again reversed course and rose to close at Y141.85.

Interest rates, which had been creeping up, were pushed down by the Bank of Japan in an effort to reassure investors. In fact, fears of a hike in the official discount rate may have added to investor concerns and helped precipitate the big Japanese stock sell-off. The Bank of Japan purchased Y200 billion ($1.4 billion) in commercial bills and Y50 billion ($357.1 million) worth of government bonds October 21 to insure adequate liquidity to satisfy the hectic trading in equities. Interest rates on bellwether government bonds fell from 6.442 percent to 5.579 percent between October 19 and October 26.

The impact of all this on the Japanese economy is a hotly debated topic. It is estimated that Y57 trillion ($407.1 billion) was stripped from the market value of Japanese securities on October 20 and that proportional amounts were lost on October 23 and 26. Estimates of the impact on gross national product growth range from reductions of 0.3 percentage point to 1.8 points. On the other hand, government officials hope that the fallout will be limited, if Japanese investors can be convinced to remain in the market and to pursue a long-term investment strategy. Corporate assessments of the damage vary widely. Most, like Sony Corp. and Nippon Telegraph and Telephone Corp., see little if any negative impact on their operations or plans. Others, like Fujitsu, Ltd. and Nissan Motor Co., Ltd., are more concerned.

Table 1: Recent Tokyo Stock Exchange Performance

Date	Nikkei 225 Stock Average	TSE Composite Stock Index	Volume (millions of shares)	Value (billions of yen)
10/12	26,284.65	2,156.17	662.32	Y3,960.6
10/13	26,400.63	2,161.69	1,336.72	3,970.7
10/14	26,646.43	2,181.47	1,401.80	4,007.0
10/15	26,428.22	2,158.61	952.89	3,965.4
10/16	26,366.74	2,152.98	767.85	3,955.3
10/19	25,746.56	2,101.17	619.74	3,860.4
10/20	21,910.08	1,793.90	485.26	3,295.9
10/21	23,947.40	1,962.41	1,116.40	3,605.5
10/22	24,404.35	1,989.49	1,408.55	3,655.2
10/23	23,201.12	1,894.97	1,138.88	3,481.6
10/24	23,298.78	1,906.32	572.73	3,502.4
10/26	22,202.56	1,818.25	665.16	3,340.6
10/27	22,834.96	1,854.27	939.84	3,406.8

Table 2: Record Losses on the TSE Nikkei Average

Rank	Points		Percentage	
	Decline	Date	Decline	Date
1	3,836.48	10/20/87	14.90%	10/20/87
2	1,203.23	10/23/87	10.00	3/5/53
3	1,096.22	10/26/87	8.69	4/30/80
4	831.32	4/27/87	7.68	8/16/81
5	658.28	5/20/87	6.97	12/14/49
6	654.81	7/20/87	6.73	3/30/53
7	647.77	6/22/87	6.61	6/24/72
8	637.33	9/16/86	5.93	8/19/81
9	620.18	10/19/87	5.41	10/9/84
10	550.45	3/30/87	5.03	8/23/81

Source: Nihon Keizai Shimbun

Probably the most interesting aspect to be revealed is that it is expectations and perceptions that link equity markets around the globe, not the actual flow of funds. Despite the relatively small amount foreign investors have put into U.S. securities, worries by American investors that a weaker dollar would drive foreign investors away from U.S. bond and equity markets is said to have been a prime cause of the New York Stock Exchange's decline. Japanese investors were worried about the Dow's drop, but many Japanese investment firms counseled their clients to hold on to their portfolios and even hunt for bargains. Although net purchases of foreign stocks by Japanese investors had been rising earlier this year, activity has leveled off in the past two months.

On the other hand, foreigners are said to have contributed to the subsequent declines of the TSE average, particularly on October 26. Japanese analysts guessed that foreigners were liquidating their Tokyo holdings in order to meet settlement obligations at home. On the upside, Japanese investors are just as happy as Wall Street that the administration and Congress seem to be moving toward a compromise that would significantly reduce the U.S. budget deficit. In any event, it is clearer than ever that barriers between national markets are dissolving and that policy cooperation and coordination is a prerequisite to success.

Jon Choy

Tokyo Seeks End To Land-Price Spiral

One consequence of Japan's recent prosperity has been a rapid increase in land prices and real estate speculation. The climb has gone so high as to put buying a house in any of the large metropolitan areas out of the reach of the middle class. In fact, the run-up of the Tokyo Stock Exchange that preceded the October 20 crash was linked to rising real estate prices -- increasing stock values meant more collateral for housing loans and an increase in housing demand in certain markets. On the other hand, a hike in housing demand produces rising real estate values and money can be put into the stock market.

Government and Liberal Democratic Party officials want to break this vicious spiral with the following tools:

- The Home Affairs Ministry has proposed raising taxes on undeveloped plots as small as 100 square meters (1,075 square feet) in the Tokyo, Osaka and Nagoya metropolitan areas. At present a special tax of 1.4 percent to 3 percent applies to lots of 300 square meters (3,226 square feet) or more in Tokyo and to lots of 500 square meters (5,376 square feet) and up in other cities. The Home Affairs Ministry would like to raise the levy effective April 1, 1988, but has not proposed an exact figure. The new tax would be in effect for at least two years and longer if necessary.

- Taxes on farm land are still an extremely sensitive issue. However, a consensus does seem to be emerging in favor of change. As it now stands, a farmer can avoid heavy assessments by agreeing to farm a plot for several years. His heirs may continue to pay low taxes and avoid inheritance taxes if they too agree to farm the land. Repeal of this tax break would deal a severe blow to owners of farm land in metropolitan areas and is bound to bring up old issues of food security. Nevertheless, the government seems willing to confront the issue at long last.

- Levying capital gains taxes on real estate transactions is another target for reform. Currently, a seller may avoid stiff levies if the money is immediately invested in other real estate, with obvious consequences for prices. Changing this popular regulation may prove politically costly, however.

- The Finance Ministry has come down hard on banks and other financial institutions that lend money for real estate speculation. An October 19 notice encourages lenders to investigate loan requests more thoroughly. The purpose of the loan, the true state of the supporting collateral (improved or not), and

lot on trade." Since a trade/reconciliation package appears unrealistic, budgetary concerns will come first for now and the trade bill will be of secondary importance.

From Wall Street's perspective this is just fine. Many observers fear that the shaky stock market will not respond well to congressional approval of what is viewed as protectionist legislation. If Congress wants to approve a bill this year, it will have to tread carefully, keeping in mind the fact that many investors are worried that the bill might spark foreign retaliation. Indeed, since there has been so much protectionist rhetoric on Capitol Hill -- and since this country's trading partners believe that nearly all the provisions of the bill run counter to their own interests -- some foreign investors have warned that passage of even a toned-down trade package could send chills through the stock and bond markets.

In the view of such observers, the wisest course may be to take no action at all. Legislators have not publicly espoused this view; on the contrary, the leadership still says that the trade bill will be on the president's desk by the end of the year. It is not clear whether this position is held by the majority of conferees -- or indeed by the leadership in private. It is true, however, that only non-controversial proposals have been discussed thus far; this is probably both because there is no consensus on controversial proposals and because no one wants to increase the uncertainty about the economy.

Consequently, there has been some talk about wrapping up work on HR 3 early next year. If the bill is sent to the president in January or early February, say observers, there is a good chance that 1988 election concerns will not affect its fate. If, on the other hand, the delay stretches into March or April, the probability of politicization increases enormously. For the present, however, Congress appears to be doing what countless economists have advocated: attacking the trade deficit by cutting the budget deficit.

Eileen M. Doherty

Notes

Supercomputers - Tokyo's new procedures for purchases of supercomputers by government agencies, research institutions and national universities (see JEI Report No. 29B, July 31, 1987) have produced sales breakthroughs for the top two U.S. supercomputer manufacturers. On October 15 Control Data Corp. revealed that it had won a contract from the Tokyo Institute of Technology -- its first supercomputer sale ever to a Japanese customer public or private. The institute, part of the national university system, ordered the new ETA-10 system made by CDC's ETA Systems Inc. supercomputer subsidiary. The $20 million unit will be installed next March.

Cray Research Inc. has also announced a first -- a supercomputer contract from Japan's public sector. The world industry leader disclosed October 26 that the Ministry of International Trade and Industry had ordered a $15 million X-MP/216 system for installation at an Agency for Industrial Science and Technology facility during the first quarter of 1988. Cray has installed eight supercomputers in Japan since mid-1983, all for private organizations. The closest it had come to a government sale before the MITI order

was a contract from Nippon Telegraph and Telephone Corp. when it was still a public corporation.

Money for the two supercomputers will come out of the Y145 billion ($1 billion-plus at Y140=$1.00) earmarked in the FY 1987 supplementary budget for public-sector purchases of big-ticket foreign products. About one-fifth of these funds, which are part of the Y6 trillion ($42.9 billion) economic stimulus package unveiled this past May (see JEI Report No. 21B, June 5, 1987), have already been committed. Still pending is the single-largest contract -- Y38.9 billion ($277.9 million) for jetliners for government use (see Table). Trade sources say Tokyo has tentatively selected Boeing Co.'s new 747-400 over the McDonnell Douglas Corp. MD-11 and Airbus Industrie S.A.'s A340. A firm order for two of the Boeing planes, which are scheduled for rollout in January 1988, is expected by yearend, with delivery set for 1991.

FY 1987 Supplementary Budget For Government's Import Purchases

(in billions of yen)

Administrative Unit	Value	Principal Items
National Diet	Y1.1	Foreign books and materials
Courts	0.1	Foreign books
Prime Minister's Office	38.9	Aircraft for government use
National Police Agency	5.9	Helicopters and guard command vehicles
Science and Technology Agency	9.2	Testing and research equipment and test plane
Environment Agency	1.0	Pollution measuring and analysis equipment
Ministry of Justice	0.1	Foreign books
Ministry of Foreign Affairs	5.3	Communications-related equipment
Ministry of Finance	3.1	Narcotics detection equipment
Ministry of Education	26.7	Supercomputer and other research equipment
Ministry of Health and Welfare	8.8	Medical research equipment
Ministry of Agriculture, Forestry and Fisheries	4.9	Gene analysis equipment
Ministry of International Trade and Industry	13.1	Supercomputer and testing, analysis research equipment
Ministry of Transport	15.3	Long-distance search and rescue plane
Ministry of Posts and Telecommunications	6.0	Space optical communications ground center and radio interferometer
Ministry of Labor	1.7	Medical precision equipment
Ministry of Construction	3.7	Helicopter for use in natural disasters
Ministry of Home Affairs	0.2	Helicopter for fire fighting
Total Imports	145.0	